

A REPORT TO INDIANA CITIZENS ON THE STATE'S FINANCES



*Connie K. Nass
Auditor of State*

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www.in.gov/auditor

Auditor of State of Indiana
Connie K. Nass
240 State House
200 W. Washington St.
Indianapolis, IN 46204-2793



Auditor of State

Connie Kay Nass

TELEPHONE (317) 232-3300
FACSIMILE (317) 232-6097
<http://www.in.gov/auditor>

To my fellow Indiana Citizens:

Thank you for taking the time to read this 11th semi-annual Report to Indiana Citizens on the State's Finances. My office prepares this Report to give Indiana Citizens a better understanding of Indiana government's true financial condition. Coming mid-way through State government's first fiscal year under a balanced budget since 1997, this issue is devoted to providing a snapshot of how the 2006 fiscal year is progressing. Interesting information within this Report includes:

- Indiana's calendar year-end Surplus balance was again negative, but exceeded the balance for the prior fiscal year by \$646 million. While this number is encouraging, it must be evaluated within the larger month-to-month trend, which shows slow, steady improvement in your state government's operating accounts.
- Over the past ten (10) fiscal years, revenues grew by 56% while expenditures grew by 62%.
- Ten years ago, Indiana's Education spending outpaced Welfare spending by \$345 million in FY1996, but after trading places in the 2002 fiscal year, annual Welfare spending now exceeds Education spending by \$800 million.
- Tax amnesty receipts of nearly \$200 million by December 31 helped offset some disappointing revenue numbers (see pages 2 and 6 for information on the tax amnesty program).
- While State Sales Tax revenues continued their regular steady growth, Individual Income Tax revenues have been unable to maintain FY2005's significant growth, and Corporate Income Tax revenues have been flat while Riverboat Wagering Tax revenues have actually declined.

This issue starts with a simple explanation of where the Surplus balance is at mid-year, and explores possible causes of the difference between last year's mid-year report and this year's. Page 3 examines the month-end "Surplus" balance for the past nine (9) fiscal years through the present, identifying the trends evident in the data. Pages 4 and 5 examine money in and money out of your Indiana government over a ten (10) year period, comparing revenues and expenditures in the aggregate, and by government function. Finally, pages 6 and 7 again present the revenue analysis for the first half of the 2006 fiscal year, including a discussion of tax amnesty revenues.

If you have questions or comments about this publication or its contents, please e-mail me at comments@audlan.state.in.us, or call (317) 232-3300. You may also view this report along with other pertinent information on our website at www.in.gov/auditor.

Sincerely,
Connie Nass
Auditor of State

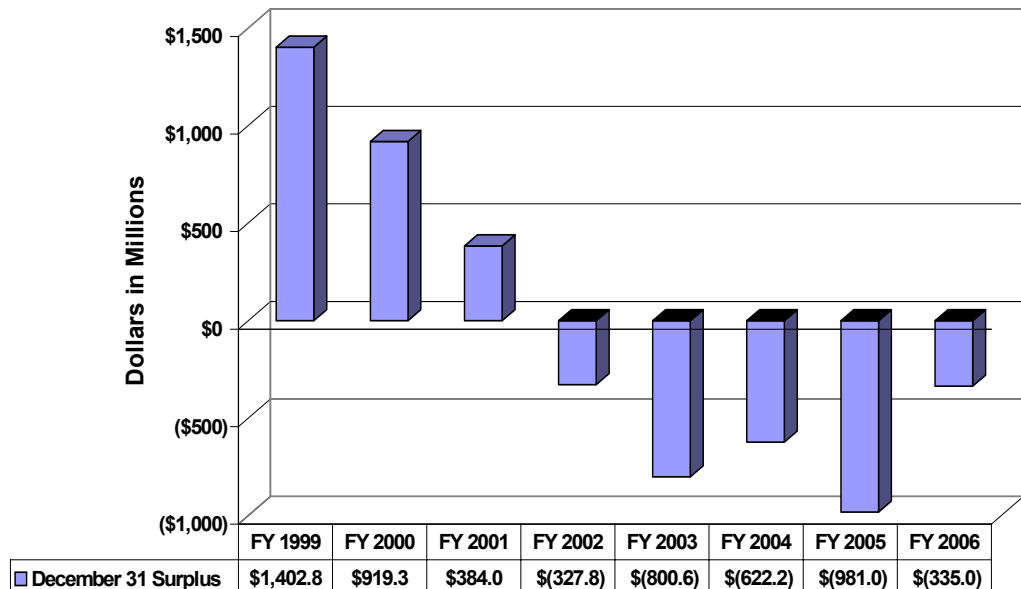
Cash and Investment Balances (all funds) as of December 31, 2005

	Surplus Accounts	Non- Surplus Accounts	Total
General Fund Cash and Investments	\$ (1,138,887,805)	\$ 205,295,783	\$ (933,592,022)
Property Tax Replacement Fund	459,572,547		459,572,547
Rainy Day Fund	323,467,468		323,467,468
Medicaid Reserve Fund	24,000,000		24,000,000
Total General Fund Cash and Investments	\$ (331,847,790)	\$ 205,295,783	\$ (126,552,007)
Non General Fund Cash and Investments	\$ -	\$ 2,542,274,279	\$ 2,542,274,279
Grand Total All Funds Cash and Investments	\$ (331,847,790)	\$ 2,747,570,062	\$ 2,415,722,272

Six months into the 2006 - 2007 budget, where do we stand?

Indiana's General Fund and Property Tax Replacement Fund Surplus ("Surplus") is the State's checking account, supporting day to day operations of State government. The Property Tax Replacement Fund component of the Surplus provides the funding for the State's share of local property tax relief. December 31 is the mid-point of State government's fiscal year. The chart on this page shows the Surplus balance at December 31 for the last eight fiscal years.

General and Property Tax Replacement Fund Surplus
at December 31



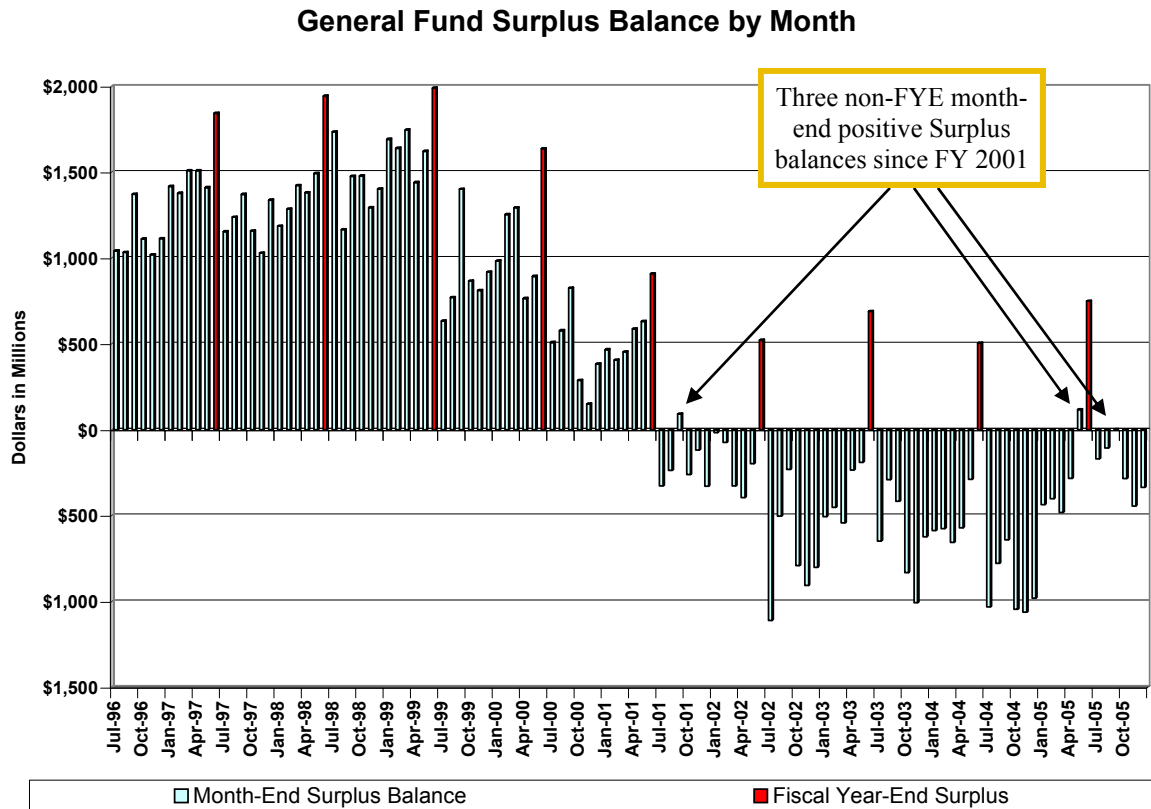
The cash and investments in the Rainy Day Fund and Medicaid Reserve Fund are used in calculating the Surplus as can be seen in the "Cash and Investment Balances" table on the bottom of the first page. The "Surplus Accounts" total in the cash and investment table [\$(331.8) million] differs from the Surplus amount [\$(335.0) million] (above) because the "Surplus Accounts" includes \$3.2 million obligated by purchase orders not yet paid.

Indiana government finished the first half of the 2006 fiscal year with a negative \$335 million Surplus balance. The good news is that this number is \$646 million higher than on the same date last year. There are several factors that may have led to that change. One is the new budget which was passed by the General Assembly in the spring of 2005. This budget, for fiscal years 2006 and 2007, is the first balanced budget passed since 1995. Another factor is the reduced rate of growth in government expenditures, both through the Budget Act and through spending restraint by the current administration. A third factor is a reduction of people employed by the State; between December 31, 2004 and December 31, 2005 full time payroll employment decreased by 2,794.

One additional factor that most certainly influenced the calendar year-end number is the recent tax amnesty program (see page 6 for discussion of tax amnesty revenues). Actual receipts from the program at year-end totaled nearly \$200 million, with reported pledges of payment that will bring the total to over \$250 million in future months. The tax amnesty program, in addition to providing a revenue "shot in the arm" for Indiana government, also increased Indiana's tax rolls so that people previously not paying taxes are now added to the tax rolls, which should bring in additional tax revenues over time.

By law the Surplus must be no less than zero at each fiscal year end (FYE), which is June 30. That requirement creates an inflated picture of the State's fiscal position at each FYE. You can see this on the chart on the next page where every red bar depicts a FYE Surplus.

Has Indiana government's cash flow improved?



For the last four fiscal years the State has delayed payments to schools and local governments at the end of each fiscal year. For the last two years the delays have been necessary to reach a Surplus at or above zero. The current balance of delayed payments is \$727 million plus a \$50 million interest free loan (due in 2013) from the Public Deposit Insurance Fund. These delayed payments must be repaid at some point.

The chart on this page shows the Surplus balance at month-end from the 1997 fiscal year through the present. This data shows the obvious downward trend that began in the 2000 fiscal year and continued through most of this decade when our month-to-month Surplus balance descended into negative territory, and remained there for over three and a half years.

The good news in this table is that we may have finally begun an upward trend. May and September 2005 ended with the first positive non-FYE Surplus balances since September 2001. Although the General Fund is still usually operating at a deficit from month-to-month, with a balanced budget, spending restraint, and modest revenue growth in Indiana government it appears things are finally headed in the right direction.

Although the State's General Fund, its operating account, was in a deficit position at December 31, 2005, the State is still able to pay its bills by temporarily relying upon money from non-surplus accounts (see table at bottom of page 1). The non-surplus accounts are accounts set up by the General Assembly to fund specific state government programs and functions. Revenues to many of these funds come in the form of user fees or Federal grants as opposed to taxes. The existence of these dedicated accounts enables Indiana government to continue to operate even when the General Fund balance is negative. The money "borrowed" in these non-surplus accounts must ultimately be repaid so the funds can be used for their intended purpose.

Money In: Recent Governmental Revenues (excludes business type activities such as unemployment insurance, lottery, etc.)

The chart to the right compares **total** governmental revenues and expenditures (as opposed to only those revenues and expenditures in the General Fund), excluding business type activities, for the last ten fiscal years. The discussion on pages 2 and 3 related only to the General Fund Surplus accounts, a subset of the total government revenues and expenditures discussed on these two pages.

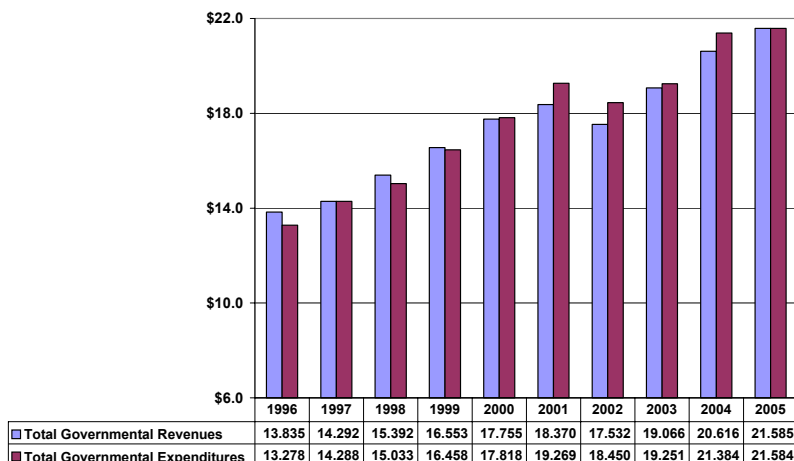
Revenues exceeded expenditures during the 1996 and 1997 fiscal years, the last fiscal years under a balanced budget prior to the current biennium. In 1998 and 1999, despite a budget that was not balanced, receipts in excess of projections kept revenues ahead of expenditures. In FY 2000, with revenues nearly exactly as projected, expenditures exceeded revenues slightly. In the next four fiscal years, expenditures exceeded revenues by \$899 million, \$918 million, \$185 million, and \$768 million, respectively. In FY 2005 revenues and expenditures were nearly equal despite a budget that was out of balance. While actual revenues grew by 56% over this period of time, actual expenditures grew by 62%.

As the second chart on this page shows, in 6 of the last 9 fiscal years (1997, 1999, 2000, 2001, 2002, and 2004) the percentage change in expenditures has surpassed the percentage change in revenues, whereas in 3 of the last 9 fiscal years (1998, 2003, and 2005) the opposite was the case.

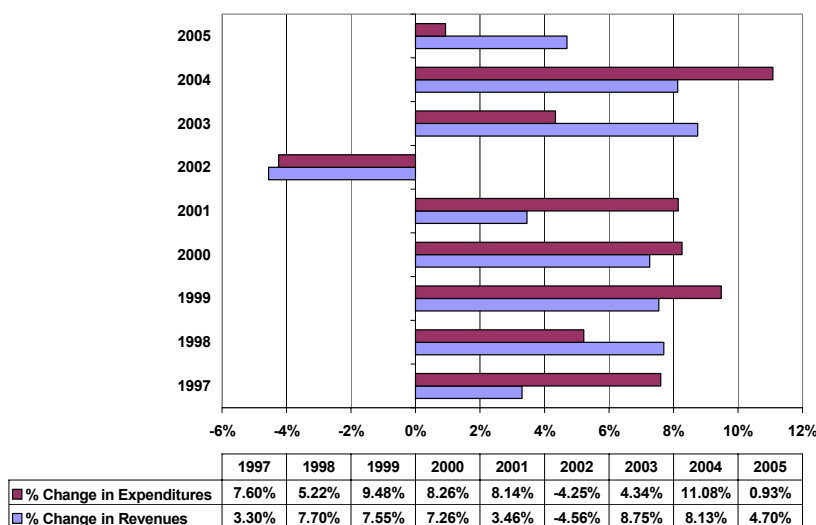
The third chart on this page breaks down government revenues by source. Tax revenues grew in each of the last 10 fiscal years except FY 2002, when tax revenues declined by over 10%, and did not rebound to pass FY 2001 levels until FY 2004.

Total tax revenues rose by 45% from FY 1996 to FY 2005, an average of 5% per year.

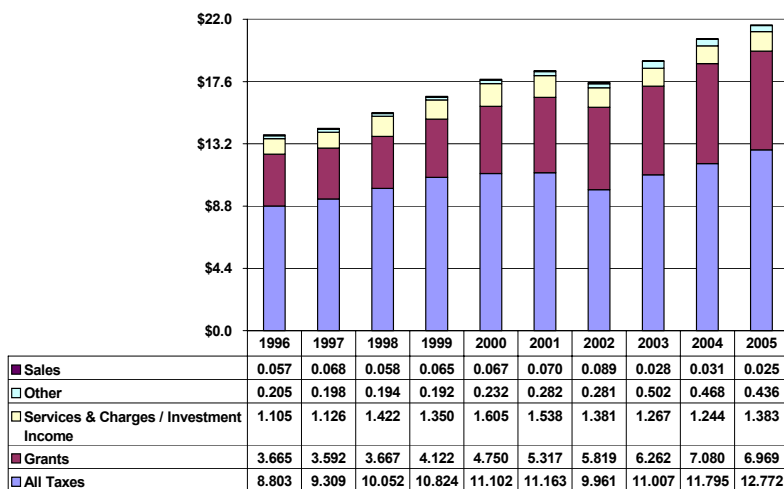
Comparison of Total Governmental Revenues and Expenditures
Fiscal Years Ending June 30, 1996 - June 30, 2005
(Dollars in Billions)



Percent Change in Governmental Revenues and Expenditures by Fiscal Year



General Governmental Revenues by Source
Fiscal Years Ending June 30, 1996 - June 30, 2005
(Dollars in Billions)



Money Out: Recent Governmental Expenditures (excludes business type activities such as unemployment insurance, lottery, etc.)

In the expenditure category, the chart on the top of this page details governmental expenditures by function (excluding business type activities) providing figures for General Government, Education, Welfare, Transportation, Public Safety (e.g., State Police, Corrections), and Other. Public Safety expenditures have grown 75% over the past ten fiscal years. Transportation (e.g., roads and bridges) spending has grown by 62%. General Government expenditures have grown by nearly 75%. Of the two largest categories, Education and Welfare, Education spending increased by 45.5%, while Welfare expenditures have gone up by 77%.

A direct comparison between the two largest spending categories, Education and Welfare, is shown in the second chart on this page.

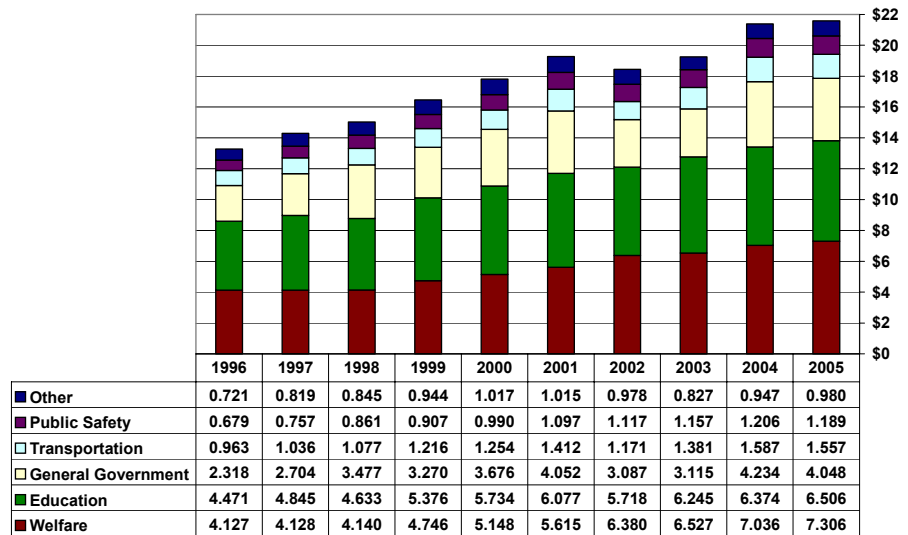
Ten years ago, Indiana spent more money on Education than on Welfare. That relationship flipped in the 2002 fiscal year.

The two most recent years have seen this difference in expenditures widen. Indiana government spent 12.3% (\$800 million) more on Welfare than on Education in FY 2005.

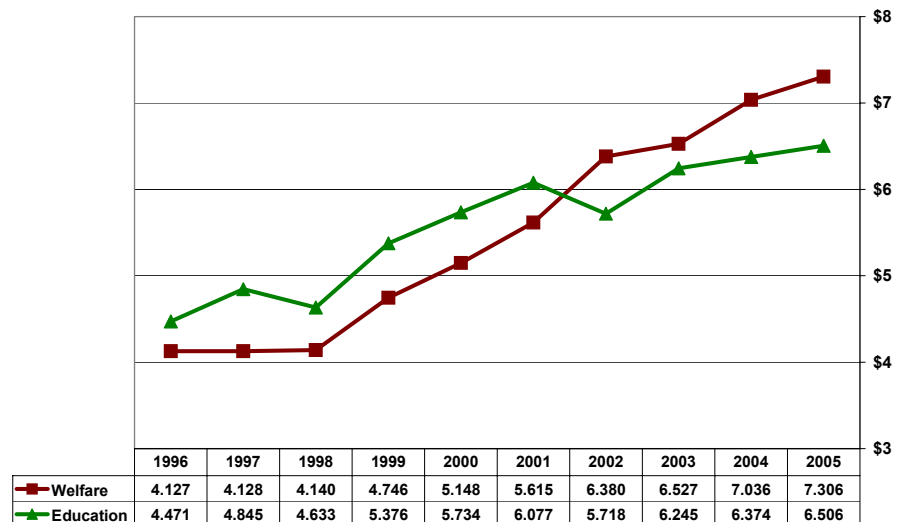
The largest portion of the State's expenses is Welfare (\$7.3 billion). Operating grants fund 68% of Welfare spending, with the majority of the remainder funded from general revenues. Some of the major Welfare components are Medicaid assistance (\$4.6 billion), Medicaid indigent care trust (\$332 million), Medicaid administration (\$137.1 million), child care and development (\$127.2 million), and temporary aid to needy families assistance (TANF) (\$117.5 million).

Education comprises 30% (\$6.5 billion) of total State expenses. All but \$750.6 million of this is funded from general revenues. Major Education expenses include tuition support (\$3.6 billion), State colleges and universities (\$1.3 billion), Teachers' Retirement Pension Fund (\$310.3 million), handicapped education (\$211.8 million), and the national school lunch program (\$144.7 million).

General Governmental Expenditures by Function
Fiscal Years Ending June 30, 1996 - June 30, 2005
(Dollars in Billions)



Comparison of Welfare and Education Expenses
For Fiscal Years Ending June 30, 1996 - June 30, 2005
(Dollars in Billions)



General and Property Tax Replacement Fund Revenue Trends (Cash Basis)

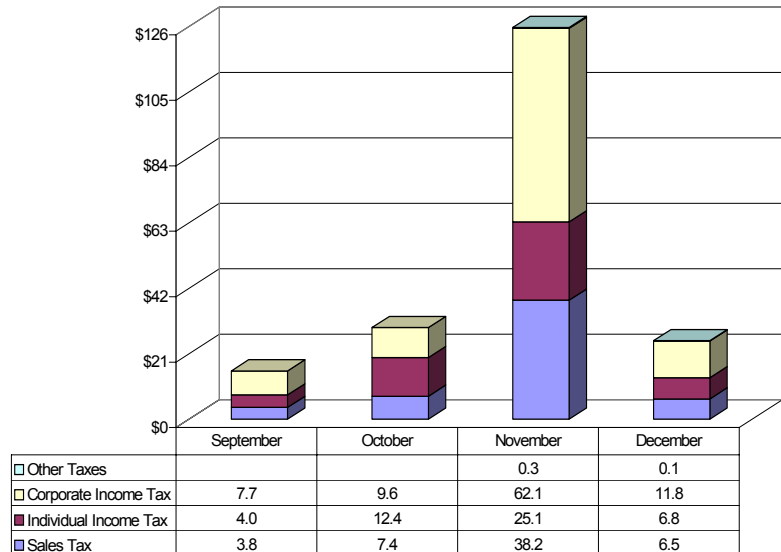
A Detailed Analysis of the Four Primary Revenue Sources Funding State Government

There are four primary revenue sources included in the General and Property Tax Replacement Fund. The revenues and percent of the total each represents for the first six months of FY 2006 are: sales tax (46.3%), individual income tax (33.9%), corporate income tax (7.4%), and riverboat wagering tax (3.4%). All other budgeted revenues account for the remaining 9%. For the first half of FY 2006 \$5.551 billion was received. That was \$179.2 million (3.3%) above the \$5.372 billion received in the first half of FY 2005. On December 14, 2005 the Economic Forecast Committee revised the FY 2006 forecast downward by \$44.8 million (0.4%) from the previous forecast issued on April 11, 2005. The revised forecast predicts \$276.2 million more revenue in FY 2006 than received in FY 2005, a projected increase of 2.4%. The four revenue streams analyzed above and on these pages do not include revenue received through the tax amnesty program, which is discussed separately below.

Tax Amnesty Revenue

From September through November 15, 2005 the State offered delinquent taxpayers the opportunity to pay back taxes without penalty if certain conditions were met. Actual receipts totaled \$195.8 million as of December 31, 2005. Of that amount \$55.9 million is sales tax, \$48.3 million is individual income tax, \$91.2 million is corporate income tax with the remaining \$0.4 million coming from cigarette and other miscellaneous taxes. When payment plan commitments are factored in, total revenue through the tax amnesty program is projected to reach \$255 million. Tax amnesty revenues were not included in revenue projections that were used to prepare the current biennial State budget which began on July 1, 2005 and ends on June 30, 2007. These tax amnesty revenues are not included in the sales, income, and wagering tax sections of these pages.

FY 2006 Tax Amnesty Revenue by Month
(Dollars in Millions)



State Sales Tax

Sales tax revenues continue a steady upward trend. The first half FY 2006 collections of \$2.572 billion are \$122.2 million (5.0%) ahead of the same period for FY 2005. This is consistent with the 5.1% growth (\$239.6 million) in state sales tax revenues from FY 2004 to FY 2005. In a December 14, 2005 revised revenue forecast from the Economic Forecast Committee, sales tax revenue projections for the fiscal year were nevertheless lowered by \$13 million, projecting growth of 4.3% for the fiscal year instead of the original 4.6% that had been projected.

Several cities and counties have adopted a food and beverage sales tax to finance certain capital improvement projects. Those additional sales taxes are not included in this report as they are collected and remitted to the government authorities which issued bonds to finance the capital improvement projects.

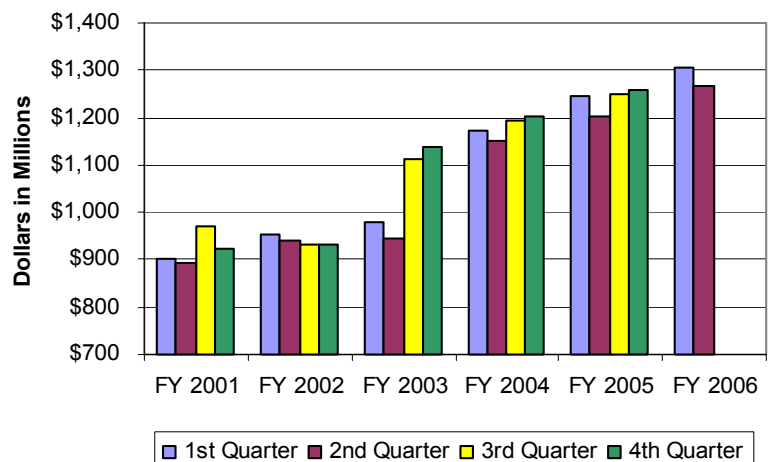
In December 2002, the sales tax was raised from 5% to 6%.

Sales Tax

(Dollars in Millions)

	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
1st Quarter	903.9	953.1	978.9	1,172.8	1,247.5	1,306.6
2nd Quarter	895.3	942.3	945.6	1,152.0	1,202.2	1,265.3
3rd Quarter	970.1	933.3	1,111.7	1,193.1	1,251.4	-
4th Quarter	924.6	932.7	1,136.4	1,203.0	1,259.4	-
Total	3,693.9	3,761.4	4,172.6	4,720.9	4,960.5	2,571.9

Sales Tax Collections



General and Property Tax Replacement Fund Revenue Trends (Cash Basis)

A Detailed Analysis of the Four Primary Revenue Sources Funding State Government

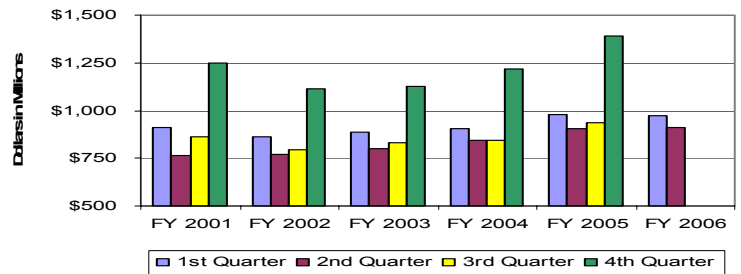
Individual Income Tax

Individual income tax receipts for the first half of FY 2006 are \$0.8 million below receipts for the same period of FY 2005. On December 14, 2005, the Economic Forecast Committee lowered its projection of the individual income tax receipts by \$163 million for the fiscal year, changing its original projection of 3.8% growth to a projected decline of 0.1% in FY 2006.

The current status of Indiana Individual Income Tax receipts reiterates the volatile nature of this revenue stream. After robust growth of 10.6% in FY 2005, the State's individual income tax revenues for the current fiscal year are currently expected, at best, to be stagnant. Individual income tax trends are better evaluated after an entire fiscal year because tax day, April 15, falls within the final quarter of the year.

Individual Income Tax (Dollars in Millions)						
	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
1st Quarter	912.6	860.2	884.7	904.0	980.8	974.2
2nd Quarter	762.1	770.8	799.7	841.6	903.7	909.5
3rd Quarter	859.3	793.7	832.8	845.4	938.3	-
4th Quarter	1,245.8	1,116.1	1,127.1	1,216.9	1,390.4	-
Total	3,779.8	3,540.8	3,644.3	3,807.9	4,213.2	1,883.7

Individual Income Tax Collections



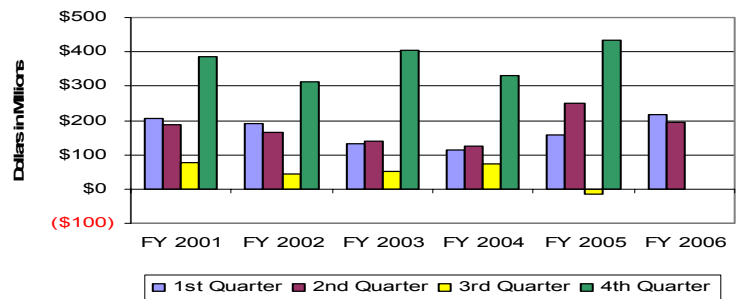
Corporate Income Tax

Corporate income tax receipts for the first half of FY 2006 were \$4.0 million (1.0%) ahead of receipts for the same period in FY 2005. The first quarter of FY 2006 exceeded the same quarter in FY 2005 by \$60.7 million while the second quarter lagged the previous year by \$56.7 million.

The Economic Forecast Committee raised its recent forecast by \$53.3 million over its previous forecast. However the Committee still project a \$14.1 million (1.7%) decline for FY 2006 from the actual collections of \$824.8 million in FY 2005.

Corporate Income Tax (Dollars in Millions)						
	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005	FY 2006
1st Quarter	205.6	189.8	132.3	114.2	157.4	218.1
2nd Quarter	187.9	164.5	140.5	125.8	249.6	192.9
3rd Quarter	75.7	44.2	50.2	73.9	(14.2)	-
4th Quarter	386.1	310.9	406.1	330.9	432.0	-
Total	855.3	709.4	729.1	644.8	824.8	411.0

Corporate Income Tax Collections



Riverboat Wagering Tax

For the first six months of FY 2006 riverboat wagering tax revenues are down \$13.1 million (6.5%) over the same period for FY 2005, and down \$38.6 million (16.9%) over the same six month period for FY 2004. Although the first quarter of FY 2006 was down \$15.4 million (18.3%) from the first quarter in FY 2005, the second quarter was up slightly by \$2.3 million (1.9%).

Riverboat Wagering Tax (Dollars in Millions)					
	Prior to FY 2003 these revenues were not deposited into this fund.	FY 2003	FY 2004	FY 2005	FY 2006
1st Quarter		49.4	114.0	84.2	68.8
2nd Quarter		86.2	114.6	118.9	121.2
3rd Quarter		118.3	175.9	180.3	-
4th Quarter		176.9	197.0	201.3	-
Total		430.8	601.5	584.7	190.0

Riverboat Wagering Tax

